STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: INTERSTATE POWER AND LIGHT COMPANY	DOCKET NOS. RPU-02-3 RPU-02-8

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ORDER REQUIRING ADDITIONAL INFORMATION

(Issued November 8, 2002)

In its review of Interstate Power and Light Company's (IPL) pending rate case, the Utilities Board (Board) has some questions and information requests regarding cost of capital issues that may be difficult for IPL and the Consumer Advocate Division of the Department of Justice (Consumer Advocate) witnesses to answer at the hearing phase dealing with these issues scheduled to begin December 3, 2002. The Board has some specific questions for IPL only and for Consumer Advocate only, and others directed to both. With respect to the questions directed to both IPL and Consumer Advocate, the Board also invites other intervenors, if they desire, to respond to the questions. For each response, IPL, Consumer Advocate, and intervenors should identify the person available at hearing to answer additional questions regarding the response.

IPL will be required to provide the following additional information:

1. The S&P credit reports for IES Utilities and Interstate Power Company, provided in Exhibit 12, Schedule A, are dated November 13, 2001.

a. File any S&P credit reports released since that date for IPL. For Alliant Energy and other subsidiaries, file any S&P credit reports released in 2001 and 2002.

b. Provide any other credit reports and supporting analyses not already filed that were issued by other rating agencies on Alliant Energy and its various subsidiaries.

2. On page 7 of Mr. Bacalao's rebuttal testimony, he references the following statement from the November 13, 2001, S&P report on IES Utilities Inc.: "IES Utilities' financial policy is characterized as aggressive due to elevated debt levels in its capital structure, an increasing capital expenditure program over the next several years, high common dividend payout, and Alliant Energy's focus on higher-risk businesses." He then states that the debt levels, capital expenditures, and dividend payout mentioned by S&P are all risks specific to IPL.

a. Provide the date and the amount of dividends that IES Utilities and Interstate Power (n/k/a Interstate Power and Light) have paid to Alliant Energy in 2001 and 2002.

b. Provide Alliant Energy's dividend payout ratio at the time of the November 13, 2001, S&P report and its current dividend payout ratio.

c. Provide documentation that the "high dividend payout ratio" reported by S&P is referencing IPL's dividend payout to Alliant Energy and not Alliant Energy's dividend payout ratio.

d. Explain which entity has direct control of the amount of dividends paid to Alliant Energy by IPL.

3. Provide any updates on what is happening with the preferred stock offering of up to $200 million and the proposed equity infusion by Alliant Energy.

4. If available, provide the utilities portion of "S&P's 2002 Corporate Ratings Criteria," dated on or about October 29, 2002.

5. In Alliant Energy's press release on its 2002 third quarter, it noted that on October 14th it had successfully completed the syndication of three 364-day revolving credit facilities totaling $915 million, which replaced the former facilities that totaled $900 million. How does the cost of money, including but not necessarily limited to interest rates, for these two financing lines differ?

6. Mr. Hanley in his rebuttal testimony, pages 27-30, asserts that an arithmetic mean is the appropriate one for use in estimating the cost of capital. What statistical assumptions lie behind the statistical conclusion that the arithmetic return is the best estimator of expected return? To what extent is each assumption realistic?

Consumer Advocate is to provide the following information:

1. On page 13 of Dr. Habr's direct testimony, he calculates a company-specific risk premium by taking the "difference between the company's common stock and debt betas times the market risk premium." What is the intellectual and academic source for this CAPM extension? Have the pros and cons of this approach been discussed in any published professional book or paper? If yes, where and what are they?

IPL and Consumer Advocate are to provide the following information. Any interested intervenor may also respond to these questions.

1. Mr. Drazen, in his direct testimony (pages 2, 13-14), argues that the reduction in risk due to the new treatment afforded by Iowa Code § 476.53 regarding new generation should be taken into account and the return on equity allowed in this case should therefore be lowered. Please comment on his statement. If you agree it should be lower for reasons given, please address the question of how this should be quantified.

2. The December 2001 edition of *Public Utilities Fortnightly* reported on its annual survey of authorized rates of return on common equity for the period October 1, 2000, through September 31, 2001. It shows 46 responses ranging from 9.98 to 12.9 percent, averaging 11.29 percent. Will investors consider this type of information when making an investment in utilities? If yes, to what extent, if any, is it appropriate for the Board to

consider this information as confirmation of any decision based upon the independent and specific analyses filed in this case?

3. According to a review in *The Economist* (February 2, 2002, pages 72-73), a recent book by Elroy Dimson, Paul Marsh, and Michael Staunton, entitled "Triumph of the Optimists," estimates a global historical average equity premium, over bonds, of 4.6 percent, "nearly half of the widely received forward-looking estimate of 8.8 percentage points from Ibbotson Associates." To what extent, if any, is it important that estimates of market risk premium reflect periods before 1926 and experience beyond the United States stock markets?

4. According to Bruner, Robert et. al., "Best Practices in Estimating the Cost of Capital: Survey and Synthesis," Financial Practice and Education, Spring/Summer 1998: "Several studies have documented significant negative autocorrelation in returns—this violates one of the essential tenets of the arithmetic calculation since, if returns are not serially independent, the simple arithmetic mean of a distribution will not be its expected value." What, if any, statistical or academic rebuttal has been made to this concern?

5. In his rebuttal testimony on page 10, Mr. Gorman asserts that Mr. Hanley has "no reasonable basis to assume a flat yield spread between the corporate and utility bonds, especially while corporate bond yields are increasing." To slightly generalize the subject, is there an inverse relationship between interest rate levels and risk premiums? If yes, provide your best

estimate of the nature of that relationship and the basis for your estimate. If no, discuss the studies or rationale supporting your position.

IT IS THEREFORE ORDERED:

Interstate Power and Light Company and Consumer Advocate shall provide the information identified in this order within ten days from the date of this order. If any intervenors wish to respond to the questions directed to both IPL and Consumer Advocate, their responses shall also be filed within ten days.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Sharon Mayer
Executive Secretary, Assistant to

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 8th day of November, 2002.